Statement from the Governor

As I settled down to write this, it struck me that what I had described as "stressful and extraordinary times" in my previous Statement seem set to last for quite some time. The global economy has become even more unpredictable and much of the traditional thinking is being put to the test as long-held paradigms are thrown overboard. Hopes of a quick and easy recovery faded away rapidly. New threats have emerged. Persistent Eurozone sovereign debt concerns have thrown markets into turmoil, driving bond-yields of vulnerable economies to record highs.

The situation has been no less alarming on the other side of the Atlantic where Standard & Poor's downgraded the credit rating of the US, a debt default was averted *in extremis*, and financial markets plunged. Business sentiment and consumer confidence have nosedived as businesses and households postpone spending and consumption. All these, together with jittery markets hungry for good news that, when they come, prove all-too-fleeting, make this super-cycle one of the most volatile ever witnessed.

In most advanced economies, the global recession had a negative impact on budgetary conditions, with many governments gradually adopting austerity measures. Under the pressure of market sentiment, fiscal consolidation and structural adjustments have become the order of the day.

Emerging economies could not long survive unscathed. So it has been for Mauritius. As we engaged to deal with these snowballing challenges, the Bank remained alert and nimble, taking decisive and timely action to protect the interest of the Mauritian economy.

As in years past, let me recapture the highlights of the year gone by and briefly comment on the present and future outlook.

- The financial health of our banks was at the top of our agenda. They remained resilient and profitable, with aggregate pre-tax profits standing at Rs13.3 billion in 2010/11, as against Rs13.9 billion in the preceding year.

- A sure sign of the fine health of our banking sector was the entry of additional operators on the banking scene, with (i) the conversion of a non-bank deposit taking institution into a full-fledged bank in June 2010 and (ii) the first Islamic bank starting operations in March 2011.

- The Monetary Policy Committee (MPC) took a number of proactive measures during the year. When the economic climate showed signs of losing momentum, the MPC decided unanimously in September 2010 to lower the Key Repo Rate (KRR) by a full 100 basis points, to support the on-going restructuring of enterprises. This policy decision went in the opposite direction of the stance that most central banks were adopting at the time. We were vindicated in our decision when domestic data releases in the first half of 2011 indicated that the economy was performing well despite the uncertain global economic environment. However, since inflationary pressures started building up, the MPC adjusted its monetary policy stance and proceeded to two successive hikes in the KRR in March and June 2011. Inflation rose sharply from 1.7 per cent in June 2010 to 5.1 per cent in June 2011.

- The year was characterised by a system plagued with excess liquidity, a situation diametrically opposite to what prevailed in many leading economies. The Bank innovated by issuing instruments of longer maturity, namely Bank of Mauritius Notes of 2-Year, 3-Year and 4-Year maturities. To complement these measures, we raised the Cash Reserve Ratio in successive steps from 5.0 per cent to 7.0 per cent. The measures were so successful that the excess reserves disappeared, with the system even experiencing short bouts of liquidity stress.

- Faced with the impact of the low interest rates on our investments in the major currencies, we actively pursued our reserves diversification strategy – you will remember that we had more than doubled our gold holdings to around 6 per cent of our reserves. We reduced our percentage holdings of US dollars which stood at around 70 per cent in 2001 down to around 30 per cent currently. We increased our holdings in high-yielding currencies – namely New Zealand dollars, Australian dollars as well as the Danish krone and the Swedish krona – and our investment in Fixed Income Securities. We entrusted a new mandate for the management of 150 million euros to the Bank for International Settlements. We added the Sovereign Investment Partnership of the World Bank as a portfolio manager for an initial tranche of 100 million US dollars. These initiatives are already bringing results and have strengthened our balance sheet. Discussions are on-going for the investment of part of our reserves in the securities of some BRICS, namely India, South Africa and China.

- We have consolidated our foreign exchange reserves during the year. The gross official international reserves of the country increased from Rs70.1 billion at the end of June 2010 to Rs81.7 billion at the end of June 2011. Furthermore, the import coverage of the country's net international reserves increased from 39.5 weeks at the end of June 2010 to 41.5 weeks at the end of June 2011.

- Currency markets showed very high volatility throughout Financial Year 2010/2011. In spite of this turbulence, we succeeded in maintaining a fairly stable exchange rate during the year under review. As observed by the International Monetary Fund in its Article IV Consultation Report of February 2011, our currency was broadly in line with economic fundamentals.

- While in most advanced economies, there was a marked deterioration in the public accounts, our public finances have proved to be quite resilient to shocks. Public sector debt remained quite close to the statutory level of 60 per cent of GDP. From 57.7 per cent as at end-December 2010, it fell to 55.9 per cent at end-June 2011. Moody's rating of Baa2 and stable outlook for Government of Mauritius bonds reflected the healthy state of our public finances.

- We struck a major blow for transparency when we took the bold decision to publish the CAMEL Ratings of all banks in the country. The first ratings were published in April 2011 and it is hoped that making these ratings widely available will lead to a better-informed consumer while encouraging banks to keep up their performance.

- The Bank, now a full member of the Islamic Financial Services Board, pursued its efforts to consolidate the enabling environment for Islamic finance. We joined in the global initiative to launch the International Islamic Liquidity Management Corporation as a founder-member in October 2010, along with ten other central banks and two multilateral organizations. We provided for staff training in Islamic finance under the Memorandum of Understanding (MoU) which we signed with Bank Negara Malaysia in October 2010.

- We also joined the International Association of Deposit Insurers as an Associate member as we are actively working towards the establishment of a deposit insurance scheme for Mauritius.

- During the year in review, in collaboration with the banking sector, we put in significant efforts to accelerate the upgrading of our national payment system to enable the clearing of cheques electronically. I am pleased to report that the cheque truncation system is now a reality in Mauritius and cheques are cleared in real time. I shall come back on this development in my next Statement.

- We made much headway in consolidating our position on the regional front. The Bank of Mauritius was appointed as the Settlement Bank of REPSS, the Regional Payment and Settlement System, to assist the cross-border payment and settlement needs of exporters and importers of COMESA member-states through their respective Central Banks. We are all set for REPSS to go live soon. The System will allow for same day settlement at much lower cost as compared to the current system which relies on settlement via universal banks established in money centres. We are also looking into the possibility of extending the REPSS platform to countries beyond COMESA.

- In our endeavour to strengthen relations and bilateral ties with peers in the region, we welcomed Governor Laporte of the Central Bank of Seychelles at the head of a delegation to share our experience in certain areas of central banking. We hosted the 31st Meeting of the Bureau of the COMESA Committee of Governors of Central Banks in August 2010.

- A further focus this year was our enhanced Communication and Outreach Programme. The most direct form of communication was through a program of regular speeches by senior Bank officials, including myself. In fact, a record number of speeches have been uploaded on the Bank's website to inform the public on the thinking of the Bank on various issues of topical interest. The MPC Statement and the post-MPC press conference have become reference points for the media and the public at large, including Mauritius-watchers overseas. The decision-making process of the MPC has thus become more transparent, enhancing its accountability.

- We also received the visit of eminent speakers from abroad, namely Paul Collier, Professor of Economics and Director of the Centre for African Studies, University of Oxford who delivered a talk on "Central Banking Challenges in Africa", and Mr Steven Barrow, Head of G10 Strategy at Standard Bank London, who addressed the topic of "Making Policy in a Difficult Global Environment".

- As indicated in my previous Statement, we concluded and signed an MoU with the Competition Commission of Mauritius to promote and maintain a competitive and sound financial environment in Mauritius.

- As a responsible citizen, the Bank brought its contribution for a greener Mauritius with the creation of a Bamboo Garden in the Midlands region situated in the central part of the island. We sought the expertise of the Agricultural Research and Extension Unit of the Ministry of Agro-Industry and Food Security to assist us in developing the Bamboo Garden and we accordingly entered into an MoU with them. At the time of writing this Statement, the project is under implementation.

- Still in the context of its programme of Corporate Social Responsibility, the Bank sponsored the National Inter Club Youth Championship for the fourth consecutive year in Mauritius and for the second time in Rodrigues.

- Tenders were launched for the construction, on a D&B basis, of the Bank's regional office at Rodrigues.

- We pursued our policy to enhance the professional competence of our staff to respond to the new exigencies facing central banks. Human resource development continued to be one of our top priorities. Training was mainly in the fields of bank supervision and macroeconomic modelling.

Looking Ahead

Our monetary policy framework has achieved commendable credibility in a short period and has even been held up as a model for similar countries by the IMF. But after four years of operation, our MPC was ripe for a review. Sir Alan Budd, a well-known figure in the world of finance in the UK and a founder-member of the Monetary Policy Committee of the Bank of England, conducted an in-depth review of the MPC. One of the areas he was specifically asked to look into was how to enhance transparency and communication. Sir Alan Budd's recommendations took on board our proposals to publish both the minutes of meetings and the pattern of individual votes. The recommendations will take effect as from the next MPC meeting (December 2011). So we will be looking at a still more transparent MPC, which will without doubt enhance its credibility.

We also have plans in the year ahead to deepen our financial market through the listing of Government securities on the stock market and conducting single-maturity auctions. By the time this Report would be in the public domain, we would be holding the online auctioning of Government paper.

The global financial crisis has highlighted the issue of systemically important financial institutions. In our case, the concern is the high degree of concentration in the banking sector, which I have raised in recent public addresses. In view of the likely implications on financial stability, the Bank intends to deal with this issue in collaboration with the banking industry.

Our country has garnered considerable praise internationally for what we have achieved so far. We continued with top rankings in leading league tables such as the Index of Economic Freedom, the Corruption Index of the Mo Ibrahim Foundation, the World Bank's Ease of Doing Business index, the Global Competitiveness Report etc. But, as investment advisers are supposed to warn their customers, past performance is no guarantee of future results. The heightened uncertainty and the turbulent external environment mean that the winners of to-morrow will be those who can adapt and evolve faster than the competition to the changing environment.

My gratitude goes to Dr the Honourable Navinchandra Ramgoolam, GCSK, FRCP, our Prime Minister, for his unstinting support during my second term of office. The year under review started with Hon. Pravind K. Jugnauth, MLA heading the Treasury. I record my thanks to him for the cordial working relations that we enjoyed during his tenure of office. After the Cabinet re-shuffle of August 2011, Hon. Charles Gaëtan Xavier-Luc Duval, GCSK, MLA, took over as Vice-Prime Minister and

Minister of Finance and Economic Development. I look forward to a fruitful working relationship with him as the Treasury and the Central Bank, with collective resolve, move the country forward.

I seize the opportunity to thank the Chairman and the Chief Executive of the Mauritius Bankers Association, the Chief Executives of banks and all the stakeholders with whom I had the pleasure of working and thank them for their collaboration and contribution to the considerable work undertaken by the Bank during this past year.

I also extend my appreciation to my two Deputy Governors and to the staff of the Bank for their contribution to the Bank's work.

As this Annual Report goes to press, the crisis is very much on and no one can really say for sure where the global economy is heading. Against this brittle setting, we will put in every effort to shore up our economy, particularly the banking sector, to make it less sensitive to external shocks. We will ensure that we will not compound these external shocks by domestic policy mistakes. The challenges on the horizon call for an exceptional degree of vigilance and enlightened policymaking. I trust that our countrymen will live up to these expectations.

Rundheersing Bheenick
7 October 2011